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In the Supreme Court of the United States

OCTOBER TERM, 1980

STANLEY DRIZIN, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether, in a summary subpoena enforcement proceeding arising out of a Securities and Exchange Commission investigation into possible violations of the federal securities laws, mere allegations by the recipients of the subpoenas that securities law violations were not likely or probable when the Commission commenced the investigation preclude enforcement of the subpoenas.

2. Whether, as a prerequisite to enforcing its subpoenas, the Commission must prove that none of the requested documents is already in its possession.

3. Whether the district court's finding that the Commission did not already possess the subpoenaed documents is clearly erroneous.

4. Whether the court of appeals correctly rejected petitioners' unsupported allegation that the Commission was engaged in a "fishing expedition."

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 622 F. 2d 512. The opinions of the district court (Pet. Apps. B and C) are not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. D) was entered on June 9, 1980. The petition for a writ of certiorari was filed on September 8, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

In August 1978, the Securities and Exchange Commission ordered that a nonpublic investigation be made to determine whether petitioners had violated or were about to violate registration and antifraud provisions of the federal securities laws. That order was based on information reported by the Commission's staff that indicated that petitioners were selling unregistered securities and were making material misrepresentations in connection with the sale of those securities. During August and September 1978, investigative subpoenas *duces tecum* issued pursuant to that order were served on petitioners and others (I R. 1–56, 60–92).[1] Those subpoenas sought testimony and documents relevant to the Commission's investigation.

Petitioners failed to appear to testify and produced no documents. Furthermore, they made no attempt to resolve any disagreement concerning the subpoenas with the Commission or its staff. In November 1978, the Commission instituted two subpoena enforcement actions in the United States District Court for the District of Colorado.[2]

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[1] "R." refers to the three-volume record filed in the court of appeals in case No. 79-1130.

[2] *SEC* v. *Blackfoot Bituminous, Inc.*, No. 78-F-1149 (filed Nov. 1, 1978); *SEC* v. *P & J Coal Co.*, No. 78-F-1247 (filed Nov. 28, 1978). These cases were consolidated in the district court.

Prior to the hearing in those cases, petitioners filed a complaint against the Commission in the same district court[3] and served the Commission with extensive discovery requests directed toward "unearthing the testimony and documentation known to the Commission as the basis of a 'likelihood' of violations when it voted for the investigative order * * *" (Pet. 6–7).[4] Petitioners claimed that the Commission had not complied with 17 C.F.R. 202.5(a) because it purportedly had failed to find that there was a likelihood of violations when it issued its order of investigation. Petitioners accordingly demanded that the Commission's investigation be enjoined and that the subpoenas be quashed.

In January 1979, the district court entered an order enforcing the Commission's subpoenas (Pet. App. C). Relying on this Court's decision in *United States* v. *Morton Salt Co.*, 338 U.S. 632 (1950), it held that enforcement of the subpoenas was appropriate because the Commission had demonstrated that the information sought was reasonably relevant to an authorized and lawful inquiry of the Commission (Pet. App. C–3, C–7),[5] that the demands were not too indefinite and did not encompass material that was privileged or otherwise exempt from disclosure (*id.* at C–7), that compliance would not be unreasonable or un-

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[3] *Blackfoot Bituminous, Inc.* v. *SEC*, No. 79–F–56 (filed Jan. 18, 1979).

[4] Petitioners sought to discover, *inter alia*, "the manner of the Commission's deliberations" (Interrogatory 3), "the documents considered by each commissioner prior to the issuance of the order" (Interrogatory 4), "the significant facts pertinent to the referenced matter substantiated by either the documents considered or statements considered" (Interrogatory 6), the contribution of officials other than the Commissioners in determining whether to order a private investigation (Interrogatories 7–9), and the nature of any complaints made against petitioners by the public (Interrogatory 10).

[5] In addition to finding that the documents sought were relevant, the district court found that petitioners had made no effort to work out their purported differences regarding the scope of the subpoenas with the Commission (Pet. App. C–8). The court noted that this provided an additional ground for rejecting petitioners' "overbreadth" arguments.

duly burdensome (*ibid.*), and that the Commission had shown prima facie that it "does not have the information requested" (*id.* at C-3). In response to petitioners' claim that the Commission had not demonstrated compliance with 17 C.F.R. 202.5(a), the court pointed out that this provision is merely descriptive of informal procedures generally followed by the Commission, and is not a binding rule (Pet. App C-6). The court also concluded that, in any event, the Commission had complied with 17 C.F.R. 202.5(a) (Pet. App. C-6). Finally, the district court declined to permit discovery into the deliberative processes leading to the investigation (*ibid.*).[6]

Following the district court's ruling in favor of the Commission in the subpoena enforcement proceedings, petitioners' counsel agreed to entry of "an adverse judgment" in the suit against the Commission because of the *res judicata* or collateral estoppel effect of the district court's decision (Pet. App. C-13 to C-14).

On consolidated appeals in all three actions, the court of appeals affirmed (Pet. App. A-1 to A-7). The court observed that all the "necessary showings for judicial enforcement [of a subpoena] were met in this case" (*id.* at A-4). It also held that the Commission need not establish "probable cause" or a "likelihood" of violations before commencing an investigation (*id.* at A-5), and that the Commission had a legitimate need for the materials that it sought (*id.* at A-6). The court further rejected petitioners' claim that the Commission was conducting a "fishing expedition," noting that petitioners had made no attempt to narrow the range of materials requested and had not presented any complaints about the subpoenas to the Commission or its staff (*ibid.*).[7]

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[6]The Commission partially responded to petitioners' discovery requests by informing them that the members of the Commission had considered and voted unanimously to issue the order of investigation and also by making a copy of the Commission's order available to petitioners.

[7]The court of appeals declined to reach petitioners' contention that the district court erred in denying discovery. Petitioners conceded that

ARGUMENT

The decision of the court of appeals correctly applies well-established legal principles to the facts of this case and does not conflict with any decision of this Court or any other court. Further review is therefore unwarranted.

1. Section 21(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(a), empowers the Commission "in its discretion [to] make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate" that Act or any rules or regulations thereunder. See also Section 20(a) of the Securities Act of 1933, 15 U.S.C. 77t(a). In aid of this investigatory power, the Commission is authorized to "subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry," and to "invoke the aid of [an appropriate district] court * * * in requiring the attendance and testimony" called for by the subpoena. Sections 21(b) and 21(c) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(b) and 78u(c). See also Sections 19(b) and 22(b) of the Securities Act of 1933, 15 U.S.C. 77s(b) and 77v(b). There is no requirement in these statutes that the Commission delay investigation until it can prove "probable cause" or "likelihood" of the very violations it seeks to investigate.

The holding of the court of appeals that the Commission is not required to prove a likelihood of violations to enforce its subpoena is consistent with settled legal principles. The purpose of an investigation is not to accuse but to inquire; not to prove a pending charge but "to discover and procure evidence * * * upon which to make one if * * * the facts thus discovered should justify doing so." *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 201 (1946). See *United States* v. *Bisceglia*, 420 U.S. 141, 146 (1975). The Commission is not required "to answer at the outset of its

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the trial court did not err if, as the court of appeals held, 17 C.F.R. 202.5(a) does not require the Commission to demonstrate a likelihood of violations (Pet. App. A-6).

investigation the possibly doubtful questions of fact and law that the investigation is designed and authorized to illuminate." *SEC* v. *Savage*, 513 F. 2d 188, 189 (7th Cir. 1975).[8] See *United States* v. *Morton Salt Co.*, 338 U.S. 632 (1950); *Oklahoma Press Publishing Co.* v. *Walling*, *supra*; *Endicott Johnson Corp.* v. *Perkins*, 317 U.S. 501 (1943).

2. In urging that the Commission is required to prove a likelihood of violations before its subpoenas may be enforced, petitioners do not rely on the Constitution or any statute. Rather, they rely exclusively on the informal description of the Commission's enforcement procedures contained in 17 C.F.R. 202.5(a). That regulation describes the usual Commission staff practice when the Commission discovers that there is a likelihood that a violation has been or is about to be committed and the issuance of process becomes necessary.[9] 17 C.F.R. 202.5(a) is merely descrip-

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[8] Accord, *SEC* v. *Dresser Industries, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 97, 573, at 97,998 n.28 (D.C. Cir. July 16, 1980) (en banc), petition for cert. pending, No. 80-354; *Dresser Industries, Inc.* v. *United States*, 596 F.2d 1231, 1235 n. 1 (5th Cir. 1979), cert. denied, 444 U.S. 1044 (1980); *SEC* v. *Arthur Young & Co.*, 584 F.2d 1018, 1024 (D.C. Cir. 1978), cert. denied, 439 U.S. 1071 (1979); *SEC* v. *Brigadoon Scotch Distributing Co.*, 480 F.2d 1047, 1053 (2d Cir. 1973), cert. denied, 415 U.S. 915 (1974); *SEC* v. *First Security Bank of Utah*, 447 F.2d 166, 168 (10th Cir. 1971), cert. denied, 404 U.S. 1038 (1972); *SEC* v. *Wall Street Transcript Corp.*, 422 F.2d 1371, 1375 (2d Cir.), cert. denied, 398 U.S. 958 (1970); *Consolidated Mines* v. *SEC*, 97 F.2d 704, 708 (9th Cir. 1938); *In re SEC*, 84 F.2d 316, 318 (2d Cir.), rev'd on mootness grounds, 299 U.S. 504 (1936).

[9] 17 C.F.R. 202.5(a) provides:

> Where, from complaints received from members of the public, communications from Federal or State agencies, examination of filings made with the Commission, or otherwise, it appears that there may be violation of the acts administered by the Commission or the rules or regulations thereunder, a preliminary investigation is generally made. In such preliminary investigation no process is issued or testimony compelled. When it appears from information obtained either with or without a preliminary investigation that there is a likelihood that a violation has been or is about to be committed and that the issuance of process may be necessary, the matter is reported to the Commission, which may

tive; it is not a provision requiring the Commission to find probable cause or a likelihood of violations before commencing an investigation, as both courts below correctly held (Pet. App. A-5, C-6). See also *SEC* v. *Dresser Industries, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,573, at 97,998 n.28, 98,006 (D.C. Cir. July 16, 1980) (en banc), petition for cert. pending, No. 80-354. Petitioners cannot point to a single judicial decision adopting a different interpretation of this provision.[10]

Petitioners also err in contending that 17 C.F.R. 202.5(a) is a substantive rule (Pet. 11). As this Court and the lower courts frequently have held, not every agency guideline or provision creates rights in persons potentially affected by that provision.[11] Unlike the provision at issue here, the Commission's substantive rules relating to investigations appear at 17 C.F.R. Part 203, entitled "Rules Relating to Investigations," and, by incorporation, in portions of 17 C.F.R. Part 201, entitled "Rules of Practice." These regulations provide specific protections in Commis-

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then order a formal investigation or examination if it is deemed necessary. Unless otherwise ordered by the Commission, the investigation or examination is nonpublic and the reports thereon are for staff and Commission use only.

[10] By its express terms, 17 C.F.R. 202.5(a) describes the usual procedure followed by the staff when there is a likelihood of violations—*i.e.*, the staff reports that information to the Commission. It has no application to situations in which there is no established likelihood of a violation but the Commission nevertheless believes that there is a good reason to investigate.

[11] See, *e.g.*, *American Farm Lines* v. *Black Ball Freight Service*, 397 U.S. 532 (1970); *Sullivan* v. *United States*, 348 U.S. 170, 172-174 (1954); *Silverman* v. *CFTC*, 549 F. 2d 28, 34 (7th Cir. 1977); *United States* v. *Lockyer*, 448 F. 2d 417, 420, 421 (10th Cir. 1971); *Modern Plastics Corp.* v. *McCulloch*, 400 F. 2d 14, 18-19 (6th Cir. 1968). Cf. *United States* v. *Caceres*, 440 U.S. 741 (1979).

Service v. *Dulles*, 354 U.S. 363 (1957) and *United States ex rel. Accardi* v. *Shaughnessy*, 347 U.S. 260 (1954), on which petitioners rely (Pet. 19), are irrelevant to the present case. Nothing in those cases suggests that the provisions involved were only "generally" followed or that they were purely "descriptive" rather than mandatory. Moreover, the rules at issue in those cases were designed to confer procedural rights on parties dealing with the agency.

sion investigations. The provision on which petitioners rely, in contrast, appears at 17 C.F.R. Part 202, which consists of "brief description[s]" of certain "Informal and Other Procedures." See 17 C.F.R. 202.1(c). These regulations summarize procedures that are "generally followed" but that "have not been formalized in rules." *Ibid.*

In any event, the Commission did explain its reason for believing that violations of the law may have occurred and that an investigation was required (see Pet. App. C-4). The Commission's August 1978 order of investigation stated expressly that the Commission's records disclosed that petitioners had not filed a registration statement. It also stated that the Commission possessed information received from its staff that tended to show that petitioners had sold unregistered securities and had engaged repeatedly in misrepresentations of material fact. In the context of a subpoena enforcement proceeding, such a recitation is more than sufficient. It demonstrates that the Commission did find a likelihood of violations, even though it was not required to do so.[12]

3. Petitioners also argue (Pet. 22-24) that, under *United States* v. *Powell*, 379 U.S. 48 (1964), the Commission was required to prove that it did not already have the documents that it requested.

However, in this case the district court found that the Commission had made a sufficient showing that it did not possess the records sought, and the court of appeals did

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[12] Petitioners' assertion that they were denied discovery into the processes leading to the Commission's decision to investigate and into the evidence before the Commission at the time it decided to investigate is meritless. In Commission subpoena enforcement actions, which are summary in nature, "[d]iscovery should be permitted only where the respondent is able to distinguish himself from 'the class of the ordinary [respondents]' * * * by citing special circumstances that raise doubts about the agency's good faith." *SEC* v. *Dresser Industries, Inc.*, *supra*, at 98,006 (citations omitted). Without this limitation, summary enforcement of agency subpoenas would be the exception rather than the rule. See also *Donaldson* v. *United States*, 400 U.S. 517, 529 (1971); *FTC* v. *Texaco, Inc.*, 555 F. 2d 862, 871-872 (D.C. Cir.) (en banc), cert. denied, 431 U.S. 974 (1977).

not disturb that finding (Pet. App. C-3, A-6). Petitioners have done nothing more than speculate that the Commission may already have some of the records (Pet. 23). In any event, there is no requirement that the Commission make such a demonstration as a prerequisite for enforcing its subpoenas.

Powell involved the construction of a provision of the Internal Revenue Code (26 U.S.C. 7605(b)) that was intended, with certain exceptions, to bar repeated examinations of a taxpayer's records for a single taxable year. The provision was designed to deal with the problem of " 'unnecessary visits and inquisitions after a thorough examination is supposed to have been had." 379 U.S. at 54. In construing that provision, this Court noted that it "does appear to require that the information sought is not already within the Commissioner's possession * * *." *Id.* at 56. That requirement stemmed from the plain text of the statute, which prohibited "unnecessary" and repetitious examinations. The more general statutes authorizing the Commission's subpoena do not contain comparable language, and there is no sound reason to imply such a limitation. The Commission's subpoena should be enforced upon a showing that "the inquiry is within the authority of the agency, the demand is not too indefinite, and the information sought is reasonably relevant." *United States* v. *Morton Salt Co.*, *supra*, 338 U.S. at 652; *Oklahoma Press Publishing Co.* v. *Walling*, *supra*, 327 U.S. at 209; *Endicott Johnson* v. *Perkins*, *supra*, 317 U.S. at 509. Both courts below correctly found that those standards were satisfied here.

The asserted conflict among the circuits on this point (Pet. 22-24) is nonexistent. In neither of the cases cited by petitioners was it even contended, much less found, that enforcement should be denied because the agency already possessed the subpoenaed documents.[13] The courts simply

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[13] *CFTC* v. *First Nat. Bullion Corp.*, 461 F. Supp. 659, 661 (S.D.N.Y. 1978), aff'd without opinion, 598 F.2d 609 (2d Cir. 1979); *SEC* v. *Brigadoon Scotch Distributing Co.*, 480 F.2d 1047, 1053 (2d Cir. 1973), cert. denied, 415 U.S. 915 (1974).

cited the discussion in *Powell* in cases in which there was no issue concerning the agency's prior possession of the materials. We are aware of no decision denying enforcement of a Commission subpoena on the ground that the Commission may already possess some of the documents sought.

4. Petitioners contend that the Commission's subpoenas should be denied enforcement because of alleged overbreadth. But both the district court and the court of appeals found that the materials requested by the Commission were relevant to its investigation (Pet. App. A-6, C-3, C-7).[14] Moreover, petitioners made no effort to discuss with the Commission any purported disagreements concerning the scope of the subpoenas (*id.* at A-6, C-8). That factor alone demonstrates that petitioners' "overbreadth" claims are without merit. *United States* v. *Morton Salt Co.*, *supra*, 338 U.S. at 653. See also *McPhaul* v. *United States*, 364 U.S. 372, 382 (1960); *United States* v. *Bryan*, 339 U.S. 323, 332 (1950).

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[14] The standard of relevance for agency investigations is met if the documents sought are "not plainly incompetent or irrelevant to any lawful purpose." *Endicott Johnson Corp.* v. *Perkins*, *supra*, 317 U.S. at 509. The standard must be a broad one for, as is true of grand jury investigations, the Commission's inquiry may not be complete "until every available clue has been run down and all witnesses examined in every proper way * * *." *United States* v. *Stone*, 429 F.2d 138, 140 (2d Cir. 1970).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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